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No. 86-422

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, AND R. FOSTER WINANS,
Petitioners,
v.
UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE REPORTERS COMMITTEE FOR FREEDOM OF THE PRESS, THE NATIONAL ASSOCIATION OF BROADCASTERS, THE NEWSLETTER ASSOCIATION, THE NEW YORK FINANCIAL WRITERS ASSOCIATION, THE MEDIA INSTITUTE, THE NEWSPAPER GUILD, THE RADIO-TELEVISION NEWS DIRECTORS ASSOCIATION, THE AMERICAN SOCIETY OF MAGAZINE EDITORS, AND THE ASSOCIATED PRESS MANAGING EDITORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

BENJAMIN W. HEINEMAN, JR.*
CARTER G. PHILLIPS
MARK D. HOPSON
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Amici Curiae

* Counsel of Record

November 14, 1986

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder authorize the prosecution of a newspaper reporter for trading secretly in securities on the basis of market-sensitive information in unpublished newspaper articles even though the reporter and his employer owe no fiduciary duty to any market participant and even though the articles when published contain no misrepresentations, are based on no inside corporate information and cause no injury to any securities investors.

2. Whether Rule 10b-5 should be construed narrowly to avoid imposing vague disclosure requirements on reporters which would interfere with the editorial processes of the print and broadcast media in violation of the First Amendment.

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INTEREST OF *AMICI CURIAE*

The Reporters Committee for Freedom of the Press ("Reporters Committee") is a voluntary association of reporters and news editors from the print and broadcast

media. It serves as a legal defense and research fund dedicated to protecting the freedom of information rights and editorial freedom of the press guaranteed by the First Amendment. Since its founding in 1970, the Reporters Committee has taken an active role in virtually every major case concerning press freedoms before the United States Supreme Court.

The National Association of Broadcasters, organized in 1922, is a nonprofit, incorporated association of more than 4,800 radio stations, 900 television stations, and the major commercial broadcast networks. One of NAB's primary concerns is maintaining the vitality of the First Amendment guarantee of freedom of the press.

The New York Financial Writers Association is made up of over 350 reporters and editors in the New York metropolitan area who are associated with national and local print and electronic media. Founded in 1938, the Association is dedicated to upholding the professional standards of business and financial journalists and to encouraging education in this specialized field.

The Newspaper Guild is a trade union representing some 40,000 employees of newspapers, magazines, wire services and related enterprises in the United States, Canada and Puerto Rico. It has been actively involved in protecting First Amendment rights.

The Radio-Television News Directors Association is a professional association of electronic journalists. The Association has over 2,000 members who gather, edit and disseminate news and other public affairs information carried by the national networks, local radio and television broadcast stations, and cable television systems throughout the nation.

The American Society of Magazine Editors has 450 members who are chief and senior editors of consumer, trade and farm magazines across the United States. The

Media Institute is a nonprofit research organization which has published numerous reports on foreign and domestic communications policy and studies on broadcast coverage of economic news. The Newsletter Association is an international trade association of 850 publishers of 2,500 newsletters and other specialized services, which provide financial and other types of information. The Associated Press Managing Editors includes more than 600 editors of newspaper members of the Associated Press, which gathers news worldwide for dissemination to 1,350 newspapers and 3,300 broadcast stations in the United States.

Amici's membership includes reporters and editors from the field of financial journalism whose professional interests are directly affected by the theory of the government's prosecution in this case, which asserts that Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, provide a permissible vehicle for enforcing criminally and civilly undefined duties of journalists to disclose to their editors and publishers any use of their employer's confidential information that may have some effect on a securities transaction. Put another way, the prosecution in this case impermissibly attempts to criminalize journalistic codes of ethics. Failure to review petitioners' convictions thus will have a significant impact on the editorial process which is critical to the print and broadcast media's ability to report news. *Amici* are filing this brief to assist the Court by informing it of the broader public interest concerns that are implicated by this prosecution.[1] *Amici* wish to emphasize, however, that they do not condone petitioner Winan's actions, which are clearly contrary to the standards of the journalistic profession.

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[1] Pursuant to Rule 36 of the Rules of this Court, the parties have consented to the filing of this brief. Copies of those letters have been filed with the Clerk of the Court.

STATEMENT

In this case, a divided panel of the United States Court of Appeals for the Second Circuit has affirmed the conviction under the securities laws of a newspaper reporter who traded in securities in reliance on market-sensitive information contained in not-yet-published newspaper articles. Pet. App. 1a-29a. The court of appeals held that Section 10(b) of the Securities Exchange Act, and Rule 10b-5 promulgated thereunder, were violated by the reporter when he "breached a duty of confidentiality to his employer by misappropriating from the [employer] confidential prepublication information, regarding the timing and content of certain newspaper columns" and used that information in trading securities. Pet. App. 10a.

The facts of the case are set forth in detail in the opinion of the district court (Pet. App. 33a-73a) and summarized by the court of appeals. Pet. App. 5a-7a. The case centers on the actions of petitioner Winans,[2] who from August 1982 to March 1984 authored the "Heard on the Street" ("Heard") column for the *Wall Street Journal* ("*Journal*"). The Heard column consists of market gossip regarding notable volumes of trading in specific securities or price movements of various stocks. The Heard column did not rely upon or release any "inside" or confidential information, nor did the column purport to provide investment advice. However, the district court found that the column had some unquantifiable impact on the prices of the securities that were the subject of a Heard column. Pet. App. 35a-36a.

Beginning in October 1983, petitioner Winans entered into an agreement with stockbroker Peter Brandt of

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[2] Because the securities fraud convictions of petitioners Felis and Carpenter are dependent on the conviction of petitioner Winans, *amici*'s legal analysis will focus on petitioner Winans' conduct.

Kidder, Peabody & Co., Inc. ("Kidder, Peabody") to disclose the general tenor of comments—favorable or unfavorable—about specific securities and the probable publication date of upcoming columns in order to permit Brandt to trade in anticipation of the column's likely effect on the market price of the subject stocks.[3] The agreement provided that profits, if any, were to be split between Winans, Brandt and petitioner Felis, another stockbroker at Kidder, Peabody, who assisted Brandt by executing many of the trades through his personal account.[4] Petitioners traded securities on the basis of information derived from the Heard column from October 1983 until March 1984, when Winans and Carpenter, in response to an investigation by the Securities Exchange Commission ("SEC"), voluntarily went to the SEC and testified concerning their activities. Pet. App. 7a.

The courts below found that Winans' trading in securities on the basis of his knowledge of the content and publication date of upcoming Heard columns violated the *Journal*'s internal rules. Specifically, the *Journal*'s conflict of interest rules provided that knowledge of forthcoming articles was "deemed" to be the "property" of the *Journal*. The *Journal*'s internal conflict of interest rules also prohibited employees from trading in securities if they knew that an article about the securities was forthcoming in the *Journal*. Winans believed (correctly) that disclosure of his agreement with Brandt and Felis

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[3] Neither the accuracy nor the tone of any column was affected by the petitioners' scheme. The scheme was based solely on the perceived value of prepublication access to the Heard column. Pet. App. 6a-7a.

[4] Petitioner Carpenter was not directly involved in the arrangement described. However, Winans made several small prepublication trades in stocks discussed in the Heard column through a brokerage account he opened in Carpenter's name. The counts upon which Carpenter was convicted involved these securities trades. Pet. App. 38a-39a.

would result in his dismissal from the *Journal*. However, Winans testified that he did not believe that he was acting illegally. Pet. 7-8.

Following a bench trial, the district court held that petitioners Winans and Felis had entered into a conspiracy to violate the securities laws and that all three petitioners [5]—Winans, Felis and Carpenter—had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Pet. App. 3a-4a.

A divided Second Circuit affirmed the securities law convictions under the Government's theory that the petitioners had violated Section 10(b) and Rule 10b-5 when they traded on information that they had "misappropriated" from the *Journal* under the terms of the *Journal*'s conflict of interest policy. The court rejected the suggestion of *amici curiae* that such a broad theory of Rule 10b-5 liability would unnecessarily interfere with the editorial process of the print and broadcast media, thereby raising a substantial First Amendment issue. The court simply held that any restrictions on First Amendment protected activities "stem from the *Wall Street Journal* . . . company rules, not from any action by the government." Pet. App. at 22a.

REASONS FOR GRANTING THE PETITION

In this criminal prosecution, the Second Circuit has adopted a major expansion of the prohibitions of Rule 10b-5 of the securities laws. For the first time, Rule 10b-5's fundamental duty to "disclose or refrain from trading" has been held to apply to a complete market *outsider*—a person who had no access to any "inside" information and who owed no fiduciary duty to any

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[5] Brandt had pleaded guilty in a separate action; he was the Government's main witness at trial.

companies whose securities he traded. Such an expansion of liability is inconsistent with this Court's opinions in *Chiarella* v. *United States*, 445 U.S. 222 (1980) and *Dirks* v. *SEC*, 463 U.S. 646 (1983).

The Second Circuit's ruling is also worthy of review by this Court because of the First Amendment problems raised by the application of the broad "disclose or refrain" rule to a newspaper reporter who obtained nonpublic information in the course of his employment. It is important to *amici* generally, and particularly to those groups involved in financial reporting, that this Court clarify their obligations under the securities laws with respect to the publication, use and dissemination of potentially market sensitive information. Accordingly, the Court should grant the petition for a writ of certiorari.

1. To understand *amici*'s concern about the conviction in this case, it is important to realize how far removed the Second Circuit's theory is from the core concerns of Rule 10b-5's traditional prohibitions on insider trading. Obviously, the Rule's primary focus is to prohibit actual misstatements that deceive the innocent public into investing in worthless securities. But the Commission has for some time held that silence by corporate insiders who are privy to corporate secrets when they trade in the securities of their corporation is also a form of fraud prohibited by the Rule. See e.g., *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); *Chiarella* v. *United States*, 445 U.S. at 230. The Commission has, therefore, required *insiders* either (a) to disclose the corporate secrets to the other party to the transaction, so that the other party can make a fully informed decision whether or not to trade or (b) to refrain completely from trading in the affected securities. *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

The traditional "disclose or refrain" rule is derived from the special duty arising from access to inside in-

formation and from the inherent unfairness of allowing an insider to benefit from that access. 40 S.E.C. at 912 & n.15. See *Chiarella* v. *United States*, 445 U.S. at 227. The SEC has attempted, with checkered success, to extend Rule 10b-5's insider doctrine to trading by "extended insiders," *i.e.*, individuals, such as financial printers, investment bank employees or law firm employees, who in the course of their employment obtain "inside" information about corporate affairs.[6] All of these cases, while arguably stretching Rule 10b-5 to its limits, 445 U.S. at 238 (Stevens, J., concurring), nevertheless focused on the misuse of non-public, *inside* information regarding the corporations whose stocks were being traded in the securities market.

Unlike previous cases of unlawful nondisclosure, there is no evidence that petitioner Winans had any access to "inside" information about the corporations whose securities were traded.[7] More important, there is absolutely no suggestion of any fiduciary duty running from Winans or his employer, the *Journal*, to any of the corporations whose securities were traded. And the government at trial dropped an alternative theory that Winans owed some duty to the public generally under the securities laws.

As the Second Circuit recognized, under its expansion of the misappropriation theory, petitioners' conviction under the securities laws rests *solely* on a violation of

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[6] *Chiarella* v. *United States*, 445 U.S. 222 (1980); *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985); *United States* v. *Newman*, 664 F.2d 12; (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983); *SEC* v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984).

[7] "The information misappropriated here was the *Journal's* own confidential schedule of forthcoming publications. It was the advance knowledge of the timing and content of these publications, upon which [petitioners traded]." Pet. App. 17a.

Winans' ethical duty to his employer, the *Journal*. Thus, the *Journal*'s internal operating rules, which are designed to protect the *Journal*'s reputation,[8] have become the basis for a securities fraud violation and criminal sanctions. In the absence of the *Journal*'s conflict rules, which have absolutely no nexus to the securities markets, or to any purpose of the antifraud provisions of the securities laws, petitioners would not be criminally liable under Section 10(b).[9]

The Second Circuit's misappropriation theory thus conflicts with the teachings of this Court in *Chiarella* v. *United States*, 445 U.S. 222 (1980) and *Dirks* v. *SEC*, 463 U.S. 646 (1983). In *Chiarella*, this Court reversed the conviction under Section 10(b) of a financial printer who had traded on the basis of his advance knowledge of takeover bids. The Court held that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." *Id.* at 235. Such a duty arises only from a "specific relationship between two parties," and Chiarella had no relationship with any

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[8] The Court recognized that the "interest" protected under its theory was the reputational interest of the *Journal*, as reflected in its conflicts policy: "[The *Journal*'s] employees should be and are barred from destroying their employer's reputation by misappropriating their employer's informational property." Pet. App. 20a-21a. *See supra* at 8 n.7.

[9] Basing liability under the securities law solely on the breach of internal employment or ethics codes leads to several anomalous results. For example, the "sources" who provided information to Winans were free to trade on their knowledge of the upcoming publication of that material. In addition, as the Court recognized, the *Journal*'s publisher would be free to trade on the content of the Heard column. Pet. App. 20a-21a. And, at other financial publications which have no express conflicts rules, reporters may engage in precisely the same conduct as Winans without fear of prosecution under the securities laws.

of the parties from whom he purchased securities.[10] *Id.* at 233.

This Court reiterated its carefully limited interpretation of the Rule 10b-5 duty to "disclose or refrain" in *Dirks*. In that case, Dirks, a broker-dealer, received nonpublic information that because of corporate fraud the assets of an insurance company, Equity Funding, were "vastly overstated," and recommended to some of his clients that they sell their Equity Funding shares. In holding that Dirks, as a stranger to Equity Funding and its shareholders, could not be held liable directly for breaching Rule 10b-5, the Court explained that "there can be no duty to disclose where the person who has traded on inside information 'was not [the corporation's] agent, . . . was not a fiduciary [of the corporation, or] was not a person in whom the sellers [of the securities] had placed their trust and confidence.'" 463 U.S. at 654, quoting *Chiarella* v. *United States*, 445 U.S. at 232.

Thus, the holdings of this Court interpreting Section 10(b) evince a clear intent to restrict the scope of that statute—in cases of failure to disclose information—to situations where there is a breach of a fiduciary duty that can be traced to the corporation whose securities have been traded or to its shareholders.[11] Certainly, it

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[10] The Court left open the question whether Chiarella could have been convicted on the theory that his misappropriation of the information on which he based his trading breached a duty to his employer, the printing company, which, in turn, owed a duty to the acquiring company in the takeover bid. Even assuming this "misappropriation" theory were adopted, the *Journal*—unlike the printing company in *Chiarella*—owed no duty to the companies whose stock was traded by petitioners.

[11] *Amici* will not address the various issues under the mail and wire fraud statutes raised by petitioners in this case. However, if the "fraud" claim is based solely on Winans' "failure to disclose to

makes sense to limit the scope of the securities laws to correcting only those informational imbalances caused by breaches of some duty owed to a market participant. The SEC is hardly capable of ferreting out all breaches of duty to all employers simply because an employee's misconduct bears some remote connection to a securities transaction. Such matters should be handled by self-policing mechanisms within the industry. Newspapers ordinarily can uncover ethical violations and punish them effectively either by terminating employment or by using civil suits against offending employees. But, regardless of what the newspaper does, the availability of adequate alternatives to the federal securities laws argues forcefully for limiting the scope of Rule 10b-5, especially where the Congress has not spoken. *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 478 (1977) (rejecting an interpretation of Rule 10b-5 that would "bring within the Rule a wide variety of corporate conduct traditionally left to state regulation"); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 40-41 (1977).

2. The Second Circuit's unprecedented expansion of "disclose or refrain" obligations in this case is particularly troublesome to amici because it interferes with the editorial process of the print media protected by the First

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his employer that he had breached the *Journal's* private rules of confidentiality . . .," (Pet. 18) then the government's attempt to enforce this disclosure obligation under the mail and wire fraud statutes infringes the First Amendment rights of *amici* just as much as enforcement of similar requirements under the securities laws. *See infra* at 12-14.

However, even if the Court were not inclined to address the convictions under the mail and wire fraud counts, *amici* strongly urge the Court to review the securities law issues because of the adverse practical effects caused by the Second Circuit's misappropriation theory as applied to pure outsiders. *See, e.g., Ball* v. *United States*, 105 S. Ct. 1668, 1673 (1985) (this Court will review the validity of a criminal conviction, even where a reversal would not reach every count of the conviction.)

Amendment. The government is now authorized to regulate aspects of the reporter-editor relationship by enforcing vague ethical obligations of a reporter to his employer if their breach may affect securities trading—obligations which will vary with the particular code of ethics adopted by particular media organizations. Such codes of ethics are not written like criminal statutes, and their violations are not intended to result in criminal sanctions. In turn, required disclosures by reporters will certainly apply pressure on editors and publishers, in making any decision whether to publish, to take into account the possibility that publication will effectuate such a "violation" of federal law.

This type of governmental intrusion into the editorial process infringes *amici*'s First Amendment freedoms. This Court has previously recognized that the editorial process, which includes the relationship and communications between reporters and editors, is constitutionally protected from "casual inquiry" by the federal government. See *Herbert* v. *Lando*, 441 U.S. 153, 174 (1979); *Richmond Newspapers, Inc.* v. *Virginia*, 448 U.S. 555, 576 (1980) (plurality opinion); *First National Bank of Boston* v. *Bellotti*, 435 U.S. 765 (1978). The government's largely gratuitous effort, sanctioned by the district court, to impose disclosure obligations on reporters directly interferes with this process by dictating without specificity indeed with extraordinary vagueness that reporters must make unspecified disclosures to their editors. Moreover, because the disclosure requirement is derived from an inherently vague anti-fraud rule *and* from inherently vague codes of journalistic ethics (not promulgated for the purpose of defining crimes), there is a cognizable risk that *amici* and their members will be chilled in their communications and decisions as to what to write or publish by the threat of potential civil or criminal sanctions.

The disclosures required by the misappropriation theory, as applied to reporters, could well affect editors

making the decision whether an article should be published, because publication is a critical element of the securities fraud. Under the Government's theory, if the reporter discloses his prior trading to his editor, the editor's decision to proceed with publication might be held to constitute aiding and abetting of the securities violation. See *IIT* v. *Cornfeld*, 619 F.2d 909 (2d Cir. 1980). For example, the government's confused and confusing theory extends far beyond the unethical conduct of petitioner Winans. It would raise questions for an editor about whether to publish if a reporter, in order to obtain more information for a story (and for that purpose alone), had given some non-inside information obtained in news gathering to a news source who might trade in the stock. Thus, the application of the "disclose or refrain" rule in the media context implicates the core concern of the First Amendment—the prohibition of restraints on publication. See, e.g., *Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. 241, 255 (1974); *CBS* v. *Democratic National Comm.*, 412 U.S. 94, 117 (1973) (plurality opinion); *Near* v. *Minnesota*, 283 U.S. 697 (1931).

Such an adverse impact on a First Amendment protected activity can only be upheld if the Second Circuit's application of its broad "misappropriation" rule in this context is necessary to serve important governmental interests. See, e.g., *NAACP* v. *Button*, 371 U.S. 415, 438 (1963); *Smith* v. *Daily Mail Publishing Co.*, 443 U.S. 97 (1979). Here, there has not been any showing of even a substantial government interest to support this intrusion into the editorial decision-making process because it is clear that Congress had no intention of applying Section 10(b) to pure "outsiders", as this Court's decisions have demonstrated, or to aid newspapers in enforcing their code of ethics.[12]

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[12] It is ironic that this prosecution, which has been justified only in terms of protecting the *Wall Street Journal* from "misappropriation" and injury to reputation, is opposed by its supposed benefici-

Instead of addressing *amici*'s First Amendment contentions directly, the Second Circuit sidestepped the constitutional issue by arguing that the "restrictions stem from the *Wall Street Journal* . . . rules, not from any action by the government." Pet App. 22a. This logic is specious. There is a vast difference between internal ethical guidelines and federal criminal prosecutions. The government is engaging in the unprecedented practice of using existing internal codes of ethics to "make" criminal cases. The editorial process is simply not subject to government intrusion because the newspaper has its own internal guidelines regulating that process. Moreover, the government's theory results in the irrational outcome that a publisher or a reporter in a news organization without clear ethical rules may engage in conduct identical to Winans' without being subject to prosecution.

The Second Circuit's opinion creates an unprecedented basis for liability under the securities law by incorporating internal company ethics rules into the federal criminal code. In doing so, the court of appeals has disregarded the well-established rule that "ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity." *Rewis* v. *United States*, 401, U.S. 808, 872 (1971). The Second Circuit's broad construction of Section 10(b) is particularly troubling because it flies in the face of this Court's repeated admonition that statutes should be construed, if at all possible, to avoid constitutional issues. See, e.g., *Lowe* v. *SEC*, 105 S. Ct. 2557, 2563 & n.24 (1985); *NLRB* v. *Catholic Bishop of Chicago*, 440 U.S. 490, 507 (1979). The adverse impact of the court of appeals' errors on *amici* and the print and broadcast media should not be left unreviewed by this Court.

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aries, representatives of substantial segments of the print and broadcast media. The reason is simple: the media have ample ability to discipline their employees' ethical violations without invoking criminal law sanctions that threaten their ability to publish and report freely.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

BENJAMIN W. HEINEMAN, JR.*
CARTER G. PHILLIPS
MARK D. HOPSON
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Amici Curiae

* Counsel of Record

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